

CITY OF BALTIMORE

WATER UTILITY FUND

FINANCIAL STATEMENTS

FOR THE FISCAL YEARS ENDED

JUNE 30, 2002 AND 2001

(WITH REPORT OF INDEPENDENT AUDITORS THEREON)

CITY OF BALTIMORE
WATER UTILITY FUND
FINANCIAL STATEMENTS
FISCAL YEARS ENDED JUNE 30, 2002 AND 2001

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CITY OF BALTIMORE

MARTIN O'MALLEY

Mayor

DEPARTMENT OF AUDITS

Room 321, City Hall

Baltimore, Maryland 21202

ERNST & YOUNG

One North Charles

Baltimore, Maryland 21201

Report of Independent Auditors

January 27, 2003

The Mayor, City Council, Comptroller and
Board of Estimates of the City of Baltimore, Maryland

We have jointly audited the accompanying financial statements of net assets of the Water Utility Fund of the City of Baltimore, Maryland, as of and for the years ended June 30, 2002 and 2001, as listed in the table of contents. These financial statements are the responsibility of the City of Baltimore, Maryland's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Water Utility Fund and do not purport to, and do not present fairly the financial position of the City of Baltimore, Maryland, as of June 30, 2002 and the changes in its financial position and its cash flows in conformity with accounting principles generally accepted in the United States of America.

As described in Note 3, the City has implemented a new financial reporting model, required by the provisions of GASB Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, as modified by GASB Statement No. 37, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: Omnibus*, and GASB Statement No. 38, *Certain Financial Note Disclosures*, as of July 1, 2001.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Water Utility Fund of the City of Baltimore, Maryland, as of June 30, 2002 and 2001, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Yovonda D. Brooks
City Auditor
Department of Audits

Ernst& Young LLP

City of Baltimore
Water Utility Fund
Statements of Net Assets
June 30, 2002 and June 30, 2001

(Expressed in Thousands)

	<u>2002</u>	<u>2001</u>
Assets:		
Current assets:		
Cash and cash equivalents.....	\$ 17,225	\$ 9,354
Accounts receivable, net:		
Service billings.....	26,873	32,095
Due from other funds.....	852	
Due from other governments.....	1,578	
Inventories.....	5,006	4,008
Current restricted assets:		
Cash and cash equivalents.....	52,781	9,237
Investments.....	5,607	32,404
Accounts receivable, net.....	3,702	8,146
Due from other funds.....	3,191	11,260
Total current assets.....	<u>116,815</u>	<u>106,504</u>
Noncurrent assets:		
Capital assets, net.....	465,282	440,371
Bond Issuance costs.....	5,734	4,326
Total noncurrent assets.....	<u>471,016</u>	<u>444,697</u>
Total assets.....	<u>587,831</u>	<u>551,201</u>
Liabilities:		
Current liabilities:		
Accounts payable and accrued liabilities.....	2,242	1,853
Accrued interest payable.....	3,420	4,746
Deposits subject to refund.....	13	13
Due to other funds.....		1,777
Due to other governments.....		1,852
Other liabilities.....	3,229	2,981
Revenue bonds payable.....	2,185	3,860
General long-term debt payable	313	284
Accounts payable from restricted assets.....	4,439	5,287
Total current liabilities.....	<u>15,841</u>	<u>22,653</u>
Noncurrent liabilities:		
Revenue bonds payable, net.....	238,438	212,387
Other liabilities.....	944	779
General long-term debt payable	1,104	1,409
Total noncurrent liabilities.....	<u>240,486</u>	<u>214,575</u>
Total liabilities.....	<u>256,327</u>	<u>237,228</u>
Net Assets:		
Invested in capital assets, net of debt.....	223,242	222,431
Restricted for:		
Debt service.....	22,477	25,875
Future capital expenditures.....	42,804	35,172
Unrestricted	42,981	30,495
Total net assets.....	<u>\$ 331,504</u>	<u>\$ 313,973</u>

See notes to financial statements.

City of Baltimore
Water Utility Fund
Statements of Revenues, Expenses and Changes in Net Assets
For the Years ended June 30, 2002 and June 30, 2001
(Expressed in Thousands)

	<u>2002</u>	<u>2001</u>
Operating revenues:		
Water Service.....	\$ 84,083	\$ 83,961
Operating expenses:		
Salaries and wages.....	24,734	24,405
Other personnel costs.....	9,026	8,891
Contractual services.....	20,006	18,800
Materials and supplies.....	6,012	6,258
Minor equipment.....	326	1,166
General government overhead.....	3,824	3,537
Bad debts.....	2,010	1,299
Depreciation.....	9,511	7,215
Amortization of bond issuance costs.....	184	184
Total operating expenses.....	<u>75,633</u>	<u>71,755</u>
Operating income.....	<u>8,450</u>	<u>12,206</u>
Nonoperating revenues (expenses):		
Gain (loss) on sale of investments.....	(1,008)	59
Interest (expense).....	(3,363)	(1,207)
Total nonoperating revenue (expense).....	<u>(4,371)</u>	<u>(1,148)</u>
Income before contributions and transfers.....	4,079	11,058
Capital contributions.....	<u>13,452</u>	<u>14,526</u>
Changes in net assets.....	17,531	25,584
Total net assets - beginning.....	313,973	288,389
Total net assets - ending.....	<u>\$ 331,504</u>	<u>\$ 313,973</u>

See notes to financial statements.

City of Baltimore
Water Utility Fund
Statements of Cash Flows
For the Years Ended June 30, 2002 and June 30, 2001
(Expressed in Thousands)

	<u>2002</u>	<u>2001</u>
Cash flow from operating activities:		
Receipts from customers.....	\$ 80,359	\$ 75,503
Receipts from interfund services provided.....	2,655	3,523
Payments to employees.....	(33,317)	(32,128)
Payments to suppliers.....	(38,004)	(25,919)
Payments for interfund services used.....	(5,601)	(3,537)
Net cash provided (used) by operating activities.....	<u>6,092</u>	<u>17,442</u>
Cash flows from capital and related financing activities:		
Transfers to escrow agent for early extinguishment of debt.....	(141,951)	
Proceeds from revenue bonds.....	176,428	14,886
Principal paid on bonds.....	(285)	(349)
Principal paid on revenue bonds.....	(3,860)	(3,198)
Interest paid.....	(7,477)	(4,460)
Acquisition and construction of capital assets.....	(34,422)	(41,293)
Capital contributions.....	13,452	14,526
Changes in restricted assets.....	39,310	564
Net cash provided (used) by capital and related financing activities.....	<u>41,195</u>	<u>(19,324)</u>
Cash flow from investing activities:		
Purchase of investments.....	5	84
Interest on investments.....	4,123	3,244
Net cash provided (used) by investing activities.....	<u>4,128</u>	<u>3,328</u>
Net increase in cash and cash equivalents.....	51,415	1,446
Cash and cash equivalents, beginning of year.....	18,591	17,145
Cash and cash equivalents, end of year.....	<u>\$ 70,006</u>	<u>\$ 18,591</u>
Reconciliation of operating income to net cash provided (used) by operating activities:		
Operating income.....	<u>\$ 8,450</u>	<u>\$ 12,206</u>
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation expense.....	9,511	7,215
Amortization of bond issuance costs.....	184	184
Amortization of early extinguishment of debt.....	(7,833)	275
Loss on early extinguishment of debt.....	(1,013)	
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable.....	5,222	(3,331)
(Increase) in due from other funds.....	(852)	
(Increase) in due from other governments.....	(1,577)	
(Increase) decrease in inventories.....	(998)	674
Increase (decrease) in accounts payable and accrued liabilities.....	389	(642)
Increase in other liabilities.....	413	387
(Decrease) in deposits subject to refund.....		(1)
Increase (decrease) in accrued interest payable.....	(1,327)	340
Increase (decrease) in restricted accounts payable.....	(848)	(389)
Increase (decrease) in due to other governments.....	(1,852)	(305)
(Decrease) in due to other funds.....	(1,777)	829
Total adjustments.....	<u>(2,358)</u>	<u>5,236</u>
Net cash provided (used) by operating activities.....	<u>\$ 6,092</u>	<u>\$ 17,442</u>
See notes to financial statements.		

CITY OF BALTIMORE
Water Utility Fund
Notes to the Financial Statements

1. Description of the Utility

The Water Utility (the Utility) is a separate utility in the Bureau of Water and Waste Water, one of four bureaus in the City of Baltimore, Maryland's Department of Public Works. In November 1978, voters approved a Charter Amendment establishing the Utility as a separate enterprise and requiring it be financially self-sustaining and operated without profit or loss to the other funds or programs of Baltimore City (the City).

These financial statements are only of the Utility's operations and are not intended to present the financial position of the City.

2. Summary of Significant Accounting Policies

The accounting and financial reporting policies of the Utility conform to accounting principles generally accepted in the United States (GAAP) and reporting standards as promulgated by the Governmental Accounting Standards Board (GASB) for proprietary funds.

The Utility follows FASB Statements and Interpretations issued on or before November 30, 1989, Accounting Principles Board Opinions, and Accounting Research Bulletins, unless those pronouncements conflict with GASB pronouncements.

Basis of Accounting

The financial statements have been prepared on the accrual basis of accounting whereby revenues are recorded when earned and expenses are recorded when incurred, regardless of when the related cash flows take place. Operating revenues are those that result from services provided by the Utility, all other revenue is considered non-operating.

Cash and Cash Equivalents

Cash and cash equivalents include amounts in demand deposits, as well as short-term investments with a maturity date within three months of the date acquired by the Utility.

Investments

Investments are reported at fair value. Investments with maturities of less than one year from purchase date are reported at cost which approximates fair value. Securities traded on national exchanges are valued at the last reported sales price.

Inventories

Inventories are stated at cost, using the moving average cost method.

CITY OF BALTIMORE
Water Utility Fund
Notes to the Financial Statements

Unbilled Water Utility User Charges

Unbilled water user charges are estimated and accrued at year-end.

Restricted Assets

Restricted assets consist of resources that are legally obligated for the acquisition and improvement of capital facilities and revenue bond repayment requirements.

Use of Restricted Assets

When an expense is incurred for which restricted and unrestricted resources are available to pay the expense, it is the Fund's policy to apply the expense first to restricted resources then to unrestricted resources.

Capital Assets

Purchased or constructed capital assets are reported at historical cost. Capitalization thresholds are \$250,000 for buildings, improvements and infrastructure; and \$5,000 for equipment.

Depreciation is computed using the straight-line method over the estimated useful lives, as follows:

Buildings.....	50 years
Improvements.....	20-50 years
Equipment.....	2-25 years
Mobile Equipment....	5-10 years

Amortization

Bond issuance costs are amortized over the life of the issue using the straight-line method, the effect of which is not materially different than under the effective interest method. Gains and losses on the early extinguishment of debt are amortized over the shorter of the life of the new or old debt.

Sick, Vacation and Personal Leave

Employees earn one day of sick leave for each completed month of service; there is no limitation on the number of sick leave days that may be accumulated. A portion of unused sick leave earned annually during each twelve-month period may be converted to cash for a maximum of three days, computed on an attendance formula. Upon retirement with pension benefits, or termination of employment after completion of twenty or more years of service without pension benefits, employees receive one day's pay for every four sick leave days accumulated and unused as of the date of separation; under any other conditions of separation, unused sick leave is forfeited. At June 30, 2002, it is estimated

CITY OF BALTIMORE
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Notes to the Financial Statements

that accumulated non-vested sick leave for the Utility approximated \$3,924,000. Sick leave benefit expenses are recorded as a percent of conversion value based on years of service, with a maximum of 100% for employees with twenty years or more of service.

Employees can accumulate a maximum of 224 vacation and personal leave days depending upon length of service, which may be taken either through time off or carried until paid upon termination or retirement. Accumulated vacation and personal leave expenses are recorded when leave is earned.

The total vacation, personal leave and conversion value of unused sick leave recorded as a liability at June 30, 2002 and 2001 is \$4,173,000 and \$3,760,000, respectively.

3. Implementation of New Accounting Principles

Effective July 1, 2001, the City adopted the provisions of GASB Statement No. 34, *Basic Financial Statements--and Management's Discussion and Analysis--for State and Local Government* as modified by GASB Statement No. 37, *Basic Financial Statements--and Management's Discussion and Analysis--for State and Local Government: Omnibus*; and Statement No. 38, *Certain Financial Statement Note Disclosures*. These statements affect the manner in which the City records transactions and presents financial information. Accordingly, the financial statements of the Utility have been prepared in keeping with the provisions of GASB Statement No. 34, Statement No. 37 and Statement No. 38. Those financial statements for the year ended June 30, 2001, presented here for comparative purposes, have been restated to meet the provisions of these GASB Statements.

Statement of Net Assets – The statement of net assets is designed to display the financial position of the Utility. The net assets of the Utility are broken down into three categories – (1) invested in capital assets, net of related debt; (2) restricted; and (3) unrestricted. The financial data for the year ended June 30, 2001 have been reclassified in net asset format as follows: capital assets (net of accumulated depreciation) are included as invested in capital assets (net of related debt), amounts restricted for debt service and for future capital expenditures have been identified as restricted net assets; and remaining net assets have been identified as unrestricted. Also, restricted assets have been classified into their components: cash and cash equivalents, investments, accounts receivable, and due from other funds.

For the Statement of Revenues, Expenses and Changes in Net Assets, data for the year ended June 30, 2001 have been reclassified to reflect the total of operating income, non-operating revenue (expense), and capital contributions as the components of the change in net assets from June 30, 2000 to June 30, 2001.

4. Deposits and Investments

The Utility participates in the City's pooled cash account. At June 30, 2002 and 2001, the Utility's share of the City's pooled cash account, including both restricted and

CITY OF BALTIMORE
Water Utility Fund
Notes to the Financial Statements

unrestricted cash, was \$18,756,000 and \$12,471,000 respectively. All of the City's pooled cash deposits are either insured through the Federal Depository Insurance Corporation (FDIC) or collateralized by securities held in the name of the City by the City's agent.

In accordance with state law, the City is authorized to invest in direct or indirect obligations of the U.S. government, certificates of deposit, repurchase agreements and related mutual funds. City policy requires that securities underlying repurchase agreements must have a market value of at least 100% of the cost of the repurchase agreement and the City takes possession of the securities when the repurchase agreement's maturity is over five days. Management believes the City has complied with this policy throughout the year.

Investments at June 30, 2002 and 2001 are summarized below. Investments represented by specific identifiable investment securities are classified as to credit risk by the three categories below:

- Category 1 - Insured or registered, or securities held by the City or its agent in the City's name.
- Category 2 - Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the City's name.
- Category 3 - Uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the City's name.

(Expressed in Thousands)

	<u>Category</u>	<u>Carrying Value</u>
June 30, 2002:	1	
Repurchase agreements.....	\$ 4,277	\$ 4,277
U.S. Treasury and Agencies.....	<u>40</u>	<u>40</u>
	<u>\$ 4,317</u>	4,317
Mutual funds.....		<u>52,540</u>
		56,857
Less: cash equivalents.....		<u>51,250</u>
Total.....		<u>\$ 5,607</u>
	<u>Category</u>	<u>Carrying Value</u>
June 30, 2001:	1	
Repurchase agreements.....	\$19,039	\$ 19,039
U.S. Treasury and Agencies.....	<u>38</u>	<u>38</u>
	<u>\$19,077</u>	19,077
Mutual funds.....		<u>19,447</u>
		38,524
Less: cash equivalents.....		<u>6,120</u>
Total.....		<u>\$32,404</u>

CITY OF BALTIMORE
Water Utility Fund
Notes to the Financial Statements

5. Allowance for Doubtful Accounts

Accounts receivable are shown net of a \$1,473,000 allowance for 2002 and a \$1,080,000 allowance for 2001.

6. Capital Assets

Capital assets activity for the fiscal years ended June 30, 2002 and 2001 were as follows (expressed in thousands):

	Balance <u>June 30, 2001</u>	<u>Additions</u>	<u>Deductions</u>	Balance <u>June 30, 2002</u>
Capital assets not being depreciated:				
Land	\$ 12,232			\$ 12,232
Construction in progress	<u>294,022</u>	<u>\$ 62,405</u>	<u>\$ 145,554</u>	<u>210,873</u>
Total capital assets not being depreciated	<u>306,254</u>	<u>62,405</u>	<u>145,554</u>	<u>223,105</u>
Capital assets being depreciated:				
Buildings and Improvements	358,916	116,690		475,606
Equipment	<u>48,330</u>	<u>881</u>		<u>49,211</u>
Total assets being depreciated	<u>407,246</u>	<u>117,571</u>		<u>524,817</u>
Less Accumulated Depreciation for:				
Buildings & Improvements	(240,921)	(7,758)		(248,679)
Equipment	<u>(32,208)</u>	<u>(1,775)</u>	<u>22</u>	<u>(33,961)</u>
Total accumulated depreciation	<u>(273,129)</u>	<u>(9,533)</u>	<u>22</u>	<u>(282,640)</u>
Total assets being depreciated, net	<u>134,117</u>	<u>106,038</u>	<u>22</u>	<u>242,177</u>
Total capital assets net	<u>\$440,371</u>	<u>\$170,443</u>	<u>\$145,576</u>	<u>\$465,282</u>
Capital assets not being depreciated:				
Land	\$ 12,232			\$ 12,232
Construction in progress	<u>253,547</u>	<u>\$ 41,141</u>	<u>\$ 666</u>	<u>294,022</u>
Total capital assets not being depreciated	<u>265,779</u>	<u>41,141</u>	<u>666</u>	<u>306,254</u>
Capital assets being depreciated:				
Buildings and improvements	358,916			358,916
Equipment	<u>47,511</u>	<u>819</u>		<u>48,330</u>
Total assets being depreciated	<u>406,427</u>	<u>819</u>		<u>407,246</u>
Less Accumulated Depreciation for:				
Buildings & Improvements	(235,406)	(5,515)		(240,921)
Equipment	<u>(30,507)</u>	<u>(1,701)</u>		<u>(32,208)</u>
Total accumulated depreciation	<u>(265,913)</u>	<u>(7,216)</u>		<u>(273,129)</u>
Total assets being depreciated, net	<u>140,514</u>	<u>(6,397)</u>		<u>134,117</u>
Total capital assets net	<u>\$406,293</u>	<u>\$34,744</u>	<u>\$ 666</u>	<u>\$440,371</u>

CITY OF BALTIMORE
Water Utility Fund
Notes to the Financial Statements

Interest is capitalized on assets constructed with tax-exempt debt. The amount of interest to be capitalized is calculated by offsetting interest expense incurred from the date of the borrowing until completion of the project, with interest earned on invested proceeds over the same period. During fiscal years 2002 and 2001, interest expense of \$4,601,000 and \$5,716,000, respectively (net of interest income of \$2,373,000 and \$1,494,000, respectively), was capitalized.

At June 30, 2002, the Utility had outstanding commitments for construction of \$53,071,000.

7. Long-term Obligations

The Constitution of Maryland requires a three-step procedure for the creation of debt by the City of Baltimore:

- Act of the General Assembly of Maryland or resolution of the majority of Baltimore City delegates
- Ordinance of the Mayor and City Council of Baltimore
- Ratification by the voters of the City of Baltimore

A summary of outstanding debt applicable to the Utility (amounts expressed in thousands) as of June 30, 2002 and 2001 is as follows:

	Balance June 30, 2001	Additions	Reductions	Balance June 30, 2002	Amounts Due Within One Year
General Long-term debt payable	\$ 1,692	\$ 9	\$ 284	\$ 1,417	\$ 313
Revenue Bonds	217,071	178,020	145,811	249,280	
Less: unamortized charges	824	8,107	274	8,657	
Total Revenue Bonds payable	216,247	169,913	145,537	240,623	2,185
Other Liabilities	3,760	413		4,173	3,229

	Balance June 30, 2000	Additions	Reductions	Balance June 30, 2001	Amounts Due Within One Year
General Long-term debt payable	\$ 2,033	\$ 8	\$ 349	\$ 1,692	\$ 284
Revenue Bonds	205,375	14,886	3,190	217,071	
Less: unamortized charges	1,099		275	824	
Total Revenue Bonds payable	204,276	14,886	2,915	216,247	3,860
Other Liabilities	3,373	387		3,760	2,981

The general obligation bonds bear interest at rates ranging from 4.0% to 9.0% and mature serially through 2011.

CITY OF BALTIMORE
Water Utility Fund
Notes to the Financial Statements

The following is a schedule of the principal and interest payments (amounts expressed in thousands) required as of June 30, 2002 to service the above debt payable by the Utility until maturity:

	<u>General Obligation</u>	
	<u>Bonds</u>	
	<u>Principal</u>	<u>Interest</u>
2003.....	\$ 313	\$ 40
2004.....	86	26
2005.....	139	18
2006.....	173	6
2007.....	106	94
2008 to 2012.....	<u>600</u>	<u>404</u>
Total.....	<u>\$1,417</u>	<u>\$588</u>

The City has issued revenue bonds, the proceeds of which were used to provide funds for capital improvements of the Utility. Assets with a carrying value of \$22,477,000 at June 30, 2002, and certain revenues of the Utility are pledged as collateral for the bonds. Bonds outstanding (amounts expressed in thousands) as of June 30 consist of:

	<u>2002</u>	<u>2001</u>
Serial bonds series 1993-A maturing in annual installments from \$1,570,000 to \$2,125,000 from July 1, 2002 through July 1, 2008, with interest ranging from 4.9% to 5.5%, payable semiannually.....	\$ 12,820	\$ 14,320
Serial bonds series 1994-A maturing in annual installments from \$615,000 to \$850,000 from July 1, 2002 through July 1, 2009, with interest ranging from 4.4% to 5.0%, payable semiannually.....	5,900	6,405
Serial bonds series 1996-A maturing in annual installments from \$685,000 to \$1,070,000 from July 1, 2001 through July 1, 2009, with interest ranging from 4.5% to 5.55%, payable semiannually.....		7,920
Serial bonds series 1998-A maturing in annual installments from \$505,000 to \$835,000 from July 1, 2001 through July 1, 2012, with interest ranging from 3.75% to 4.8%, payable semiannually.....		7,975

CITY OF BALTIMORE
Water Utility Fund
Notes to the Financial Statements

	<u>2002</u>	<u>2001</u>
Serial bonds series 2000-A maturing in annual installments from \$525,000 to \$1,650,000 from July 1, 2001 through July 1, 2021, with interest ranging from 4.5% to 6.0%, payable semiannually.....		21,025
Serial bonds series 2002-A maturing in annual installments from \$1,855,000 to \$1,975,000 from July 1, 2009 through July 1, 2021, with interest at Muni-CPA to 5.0%, payable semiannually	24,600	
Term bonds series 1993-A with interest at 5.6%, payable semiannually, due July 1, 2013.....	12,200	12,200
Term bonds series 1993-A with interest at 5.65%, payable semiannually, due July 1, 2020.....	23,900	23,900
Term bonds series 1994-A with interest at 6.0%, payable semiannually, due July 1, 2015.....	6,250	6,250
Term bonds series 1994-A with interest at 5.0%, payable semiannually, due July 1, 2024.....	10,190	30,475
Term bonds series 1996-A with interest at 5.8%, payable semiannually, due July 1, 2015.....		7,845
Term bonds series 1996-A with interest at 5.5%, payable semiannually, due July 1, 2026.....		23,115
Term bonds series 1998-A with interest at 5.375%, payable semiannually, due July 1, 2015.....		2,765
Term bonds series 1998-A with interest at 5.0%, payable semiannually, due July 1, 2018.....		3,220
Term bonds series 1998-A with interest at 5.0%, payable semiannually, due July 1, 2028.....		14,890
Term bonds series 2000-A with interest at 5.75%, payable semiannually, due July 1, 2030.....		19,880
Term bonds series 2002-A with interest at 5.0%, payable semiannually, due July 1, 2023.....	4,250	
Term bonds series 2002-A with interest at 5.0%, payable semiannually, due July 1, 2027.....	9,845	

CITY OF BALTIMORE
Water Utility Fund
Notes to the Financial Statements

	<u>2002</u>	<u>2001</u>
Term bonds series 2002-A with interest at 5.125%, payable semiannually, due July 1, 2032.....	15,385	
Term bonds series 2002-A with interest at 5.125%, payable semiannually, due July 1, 2042.....	64,840	
Term bonds series 2002-B with interest at Auction Rate, payable monthly, due July 1, 2037.....	18,300	
Term bonds series 2002-C with interest at Auction Rate, payable monthly, due July 1, 2037.....	40,800	
Bond anticipation notes series 2001-A, floating interest rate, payable monthly, due July 1, 2003.....		14,886
	249,280	217,071
Less unamortized charges.....	8,657	824
	<u>\$240,623</u>	<u>\$216,247</u>

The portion of revenue bonds that is due within one year for the Utility is \$2,185,000.

The term bonds series 1993-A due July 1, 2013, are subject to redemption at par prior to maturity by operation of a mandatory sinking fund on or after July 1, 2009, at annual principal amounts ranging from \$1,100,000 to \$1,350,000. The term bonds series 1993-A due July 1, 2020, are subject to redemption at par prior to maturity by operation of a mandatory sinking fund on or after July 1, 2014, at annual principal amounts ranging from \$1,450,000 to \$2,000,000. The term bonds series 1994-A due July 1, 2015, are subject to redemption at par prior to maturity by operation of a mandatory sinking fund on or after July 1, 2010, at annual principal amounts ranging from \$895,000 to \$1,200,000. The term bonds series 1994-A, due July 1, 2024, are subject to redemption at par prior to maturity by operation of a mandatory sinking fund on or after July 1, 2016, at annual principal amounts ranging from \$1,265,000 to \$6,320,000.

The serial bonds series 1994-A are subject to redemption prior to maturity beginning on and after July 1, 2004, at redemption prices ranging from 102% to 100% of the principal amount. The serial bonds series 2002-A maturing on and after July 1, 2017 are subject to redemption prior to maturity beginning on and after July 1, 2012 at par plus accrued interest thereon.

On April 24, 2002 the City sold \$178,020,000 of project and refunding revenue bonds for the Utility. This transaction was undertaken to primarily refund certain revenue bonds and to provide additional capital for future projects. The city placed \$124,945,000 of the Utility Bond proceeds into an irrevocable trust for the purpose of providing sufficient funds to pay all future principal and interest requirements to extinguish \$127,065,000 of

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the Utility's existing debt. The advance refunding met the requirements of an in-substance defeasance and accordingly the assets and liabilities have been removed from the statement of net assets.

As a result of the advance refunding, the City increased its debt service requirement by \$48,007,000 in the Utility Fund. The economic gain resulting from the Utility Fund transaction was \$781,000.

The term bonds series 2002-A due July 1, 2023 are subject to redemption at par prior to maturity by operation of a sinking fund on or after July 1, 2022 at an annual principal amount equal to \$2,075,000. The term bonds series 2002-A due July 1, 2027 are subject to redemption prior to maturity by operation of a sinking fund on or after July 1, 2024 at annual principal amounts ranging from \$2,280,000 to \$2,400,000. The term bonds series 2002-A due July 1, 2032 are subject to redemption prior to maturity by operation of a sinking fund on or after July 1, 2028 at annual principal amounts ranging from \$2,780,000 to \$3,070,000. The term bonds series 2002-A due July 1, 2042 are subject to redemption prior to maturity by operation of a sinking fund on or after July 1, 2033 at annual principal amounts ranging from \$3,565,000 to \$4,355,000. The term bonds series 2002-B due July 1, 2037 are subject to redemption at par prior to maturity by operation of a mandatory sinking fund on or after July 1, 2032 at annual principal amounts ranging from \$2,700,000 to \$3,000,000. The term bonds series 2002-C due July 1, 2037 are subject to redemption at par prior to maturity by operation of a mandatory sinking fund on or after July 1, 2015 at annual principal amounts ranging from \$1,000,000 to \$1,700,000.

Principal maturities and interest (amounts expressed in thousands) of revenue bonds are as follows:

Fiscal year ended June 30,	Principal	Interest
2003.....	\$ 2,185	\$ 9,453
2004.....	2,295	12,360
2005.....	2,405	12,244
2006.....	2,515	12,121
2007.....	2,655	11,988
2008 to 2012	20,030	57,269
2013 to 2017.....	32,075	50,277
2018 to 2022.....	37,310	40,822
2023 to 2027.....	20,940	33,613
2028 to 2032.....	24,440	28,264
2033 to 2037.....	45,785	19,848
2038 to 2042.....	45,625	8,268
2043 to 2047	<u>11,020</u>	<u>257</u>
	<u>\$249,280</u>	<u>\$296,784</u>

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In prior years, the Utility also defeased revenue bonds by placing the proceeds of new debt issues in an irrevocable trust to provide for all future debt service payments on the old debt. Accordingly, the trust account assets and the liability for the defeased debt are not included in the Utility's financial statements. At June 30, 2002, \$21,080,000 of debt outstanding is considered defeased, which includes debt defeased during the current year.

The Utility has various revenue bond covenants that generally require the Utility to maintain rates sufficient to meet the operating requirements of the Utility and an operating reserve as defined in the revenue bond indentures. As of June 30, 2002, the rate requirements were met, and management believes the Utility is in compliance with all significant requirements of the indentures.

8. Pension Plan

Classified employees of the Utility are required to join the City of Baltimore's Employees' Retirement System (ERS). The ERS is a multiple-employer cost sharing defined benefit pension plan administered by the City of Baltimore Retirement System. The ERS provides retirement, disability and death benefits to plan members and beneficiaries. The plan is managed by a Board of Trustees in accordance with Article 22 of the Baltimore City Code. Plan benefit provisions may be amended only by the City Council. The Utility's share of contributions to the plan were \$1,413,000 in 2002, \$936,000 in 2001, and \$1,016,000 in 2000. The Utility contributed 100% of the required contribution each of the three years. ERS issues a publicly available financial report that may be obtained by writing to the City of Baltimore Retirement Systems, Room 640 City Hall, 100 N. Holliday Street, Baltimore, MD 21202.

9. Postemployment Benefits

City administrative policy provides that certain postemployment benefits, other than pension benefits, be provided to all employees of the Utility. These benefits include certain health care and life insurance benefits. All employees who retire are eligible to receive these benefits. Such benefits are accounted for on a cash basis so that payments during the current year represent benefit coverage for currently retired employees or their beneficiaries. During fiscal years 2002 and 2001, the Utility's share of the City postemployment benefit payments were \$2,498,000 and \$2,457,000, respectively.

10. Risk Management

The Utility participates in the City's risk management program. The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. During fiscal year 1987, the City established the Risk Management Fund (an internal service fund) to account for and finance its uninsured risks. The City's risk financing techniques include a combination of risk retention through self-insurance and risk transfer through the purchase of commercial insurance. The Risk Management Fund services all claims for risk of loss, including

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general liability, property and casualty, workers' compensation, unemployment compensation, automobile physical damage and bodily injury and sundry other risks. Commercial insurance coverage is provided for each property damage claim in excess of \$750,000 with a cap of \$250,000,000. Settled claims have not exceeded this commercial coverage in any of the past three years. The City also provides medical insurance coverage for all employees and retirees. Employees are required to pay a percentage of the annual cost of the medical plans and the remaining costs are paid by the City's internal service fund.

All funds of the City participate in the program and make payments to the Risk Management Fund based on actuarial estimates and historical cost information of the amounts needed to pay prior and current year claims. During fiscal years 2002 and 2001, the Utility's share of the City's cost was \$5,211,000 and \$4,761,000, respectively.

11. Commitments and Contingencies

The Utility has received State grants of \$82,000 for 2002. Entitlement to grant resources is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable Federal and State regulations, including the expenditure of the resources for eligible purposes. Substantially all grants are subject to financial and compliance audits in accordance with grantors' requirements. Any disallowances as a result of these audits become a liability of the Utility. As of June 30, 2002, the Utility estimates that no material liabilities will result from such audits.

The City of Baltimore is currently negotiating with the U.S. Department of Justice and the Environmental Protection Agency to curtail possible litigation due to alleged City violations of the Clean Water Act due to past discharges and overflows from the City sewer system. The City is voluntarily entering into a Consent Decree to rehabilitate its aging sewer infrastructure and correct historical overflow mechanisms. The Consent Decree is one of many the U.S. Department of Justice is and has currently negotiated with major east coast cities with aged sewer and storm water infrastructures. The City is proactively negotiating to ramp up its remedial efforts to address discharge and overflow concerns of the State and Federal regulatory agencies. These efforts are ambitious and the cost of the construction and maintenance are estimated to range between \$500 to \$700 million dollars over the next decade and beyond. The City has committed to financing these remedial efforts through a combination of water and waste water revenue bonds in conjunction with all available State and Federal assistance.